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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
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SEP 23 2011
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COMMISSIONERS

GARY PIERCE, Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERTIES THROUGHOUT ARIZONA.

Docket No. G-01551A-10-0458

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RESPONSE BRIEF OF

ARIZONA INVESTMENT COUNCIL

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INTRODUCTION

The Arizona Investment Council ("AIC") submits this Response Brief in support of the July 15, 2011 Proposed Settlement Agreement (the "Settlement Agreement").

As we stated in our Opening Brief, the Settlement Agreement is the product of significant time, effort, analysis and compromise by multiple signatories—specifically, Southwest Gas Corporation ("Southwest Gas" or the "Company"), the Commission's Utilities Division Staff ("Staff"), the Southwest Energy Efficiency Project ("SWEEP"), Cynthia Zwick and the Natural Resources Defense Council ("NRDC"). AIC strongly urges the Commission to approve the Settlement Agreement, including one of its decoupling mechanisms.

The Arizona Residential Utility Consumer Office ("RUCO") is the lone objector to the Settlement Agreement. In its opening statement, RUCO promised to present the Commission a "better alternative" than the decoupling proposals set forth in the Settlement Agreement.[1] RUCO clearly failed. As discussed in our Opening Brief, no one—not even RUCO's own expert—believes that RUCO's proposal is a good idea. Moreover, RUCO's arguments against the Settlement Agreement are based on speculative theories and unsubstantiated accusations.

There is no doubt that the best option for the Company, its ratepayers, the public's interest and the Commission is approval of the Settlement Agreement and either its Alternative A or B in its entirety.

RUCO'S LACK OF EVIDENCE

Before addressing RUCO's specific arguments on the Settlement Agreement and decoupling, it is worth noting that much of RUCO's case is based on the testimony of Dr. Ben Johnson. While Dr. Johnson has considerable experience providing testimony on utility-related

[1] Hr. Tr., Vol. I, p. 43, ll. 7-14.

issues, he lacks experience in the area most at issue here—decoupling. He has never testified in a proceeding regarding revenue decoupling for a gas distribution company; he has never been retained to perform a review of the effectiveness of a revenue decoupling mechanism for a gas distribution company; and he did not participate in the Commission's decoupling workshops.[2] At most, Dr. Johnson "may" have issued a "short piece of testimony . . . maybe in Georgia" on the general subject of decoupling "a long time ago."[3]

In contrast, the witnesses who testified at the hearing in support of decoupling have substantial experience and expertise. Dr. Dan Hansen has significant experience evaluating customer responses to decoupling and has been hired by regulators in recent years to conduct independent analyses of decoupling mechanisms used by several utilities.[4] Ralph Cavanagh has been working on energy efficiency standards and the impact of decoupling on achieving those goals for more than 30 years.[5] Similarly, Jeff Schlegel has worked in the industry for more than 30 years and has spent the past ten years trying to improve energy efficiency in Arizona through various programs, including decoupling.[6]

The Settlement Agreement Benefits Ratepayers and the Public

As explained in AIC's Opening Brief, the Settlement Agreement contains two decoupling options: Alternative A is a Lost Fixed Cost Recovery ("LFCR") mechanism and Alternative B is a revenue-per-customer decoupling ("Decoupling") mechanism. While RUCO continually describes them as revenue guarantees, in fact, both mechanisms are narrowly tailored to allow the Company an opportunity to recover the test year fixed costs that the Commission has found

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[2] Hr. Tr., Vol. III, p. 598, ll. 10-21.
[3] Hr. Tr., Vol. III, p. 654, ll. 7-15.
[4] Hr. Tr., Vol. II, p. 264, l. 9 – p. 265, l. 7; AIC-1, p. 1, ll. 9-22 and DGH-1.
[5] Hr. Tr., Vol. II, p. 365, ll. 2-11.
[6] Hr. Tr., Vol. II, p. 422, l. 1 – p. 423, l. 19.

necessary for Southwest Gas to continue to provide safe, reliable and adequate service. The mechanisms themselves provide significant benefits, both to ratepayers and the public. They remove the Company's disincentive to promote energy efficiency and encourage it to help customers lower bills and to meet or exceed the Commission's Gas Utility Energy Efficiency Standards ("EE Standards").[7] Moreover, as detailed in Staff's Opening Brief, the Settlement Agreement contains a number of additional provisions aimed at fostering and protecting ratepayer interests.[8]

A. Delay in Infrastructure Costs Is Not Decoupling's Primary Ratepayer Benefit

A central theme of RUCO's opposition is the notion that the "primary ratepayer benefit" of decoupling is missing in this case. Specifically, RUCO's Director, Jodi Jerich, testified its primary benefit is the ability for the utility to delay incurring generation and infrastructure costs and, because Southwest Gas is only a distribution facility, that benefit is missing.[9] Ms. Jerich's "primary benefit" theory runs counter to both the Policy Statement and the evidence.

The Policy Statement identifies several benefits of decoupling, but markedly does not identify a "primary benefit."[10] As Dr. Hansen discussed, postponing infrastructure is <u>not</u> the primary justification for decoupling; its primary rationale is to help the utility work with customers to <u>lower</u> their bills by using <u>less</u> energy without sacrificing service satisfaction.[11] Company witness John Hester reiterated that decoupling for natural gas distribution companies is about both immediate and long-term savings—with the focus on immediate customer benefits.[12]

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[7] Hr. Tr., Vol. I, p. 244, l. 15 – p. 245, l. 16.
[8] Staff's Opening Brief, pp. 5-6.
[9] Hr. Tr., Vol. III, p. 692, l. 16 – p. 693, l. 7; RUCO's Opening Brief, p. 5, l. 20 – p. 6, l. 7.
[10] RUCO-1.
[11] Hr. Tr., Vol. II, p. 266, ll. 11-23.
[12] Hr. Tr., Vol. I, p. 134, l. 10 – p. 136, l. 7.

Moreover, Ms. Jerich's "primary benefit" theory is undermined by one of her own exhibits. At hearing, RUCO sought to introduce a number of out-of-state regulatory decisions as evidence supporting its opposition to decoupling.[13] Interestingly, one of these decisions held that decoupling is <u>more</u> appropriate for gas distribution utilities than for vertically integrated electric utilities. *See Petition of S. Ind. Gas & Elec. Co.*, 289 P.U.R.4th 9 (Ind. Util. Reg. Comm'n 2011).

B. Return on Equity and Earnings Tests Are Significant and Aggressive Consumer Protections

Alternative B of the Settlement Agreement requires the Company to file and Staff to review an annual report that contains an earnings test to ensure that Southwest Gas does not earn a return on common equity ("ROE") higher than 9.50. Notably, that 9.50 ROE is 25 basis points below the 9.75 ROE recommended by Staff in its direct case.[14]

RUCO tries to cast the 9.50 ROE as a great deal for shareholders, implying it should be lower to account for the decoupler's perceived reduction in risk.[15] However, both Dr. Hansen and Mr. Cavanagh testified that a 25-point reduction in ROE is the maximum reduction that has been applied by any other regulator.[16]

RUCO also tries to turn the earnings test on its head by calling it a "guarantee" that the Company will earn 9.50%. Dr. Johnson suggested that the Company will monitor its earnings and, in years that the earnings might exceed the cap, the Company will "find ways to spend money" to avoid that.[17] This charge has absolutely no factual basis. As Judge Nodes pointed

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[13] Hr. Tr., Vol. III, p. 713, ll. 4-12.
[14] RUCO-1, p. 8, ¶ 2.2.
[15] RUCO's Opening Brief, p. 8, ll. 7-13.
[16] Hr. Tr., Vol. II, p. 347, ll. 6-11 and p. 400, ll. 16-22.
[17] Hr. Tr., Vol. III, p. 678, l. 9 – p. 679, l. 5.

out, Staff and/or RUCO will be carefully reviewing the Company's operating expenses as a part of the earnings test review, thereby eliminating this supposed "temptation" to spend.[18] Contrary to RUCO's characterizations, the testimony made it clear that the earnings test is a unique, stringent and aggressive customer protection.[19]

C. Cost Cutting Will Benefit Customers

The Settlement Agreement requires the Company to reduce annual expenses by an average of $2.5 million. In light of the fact that Dr. Johnson originally testified in favor of cost minimizing incentives,[20] one would expect RUCO to acknowledge the benefit afforded. Instead, RUCO argues customers won't receive any benefit until the Company's next rate case.[21] However, Mr. Olea explained that the expense reduction combined with the ROE cap will actually have a much more immediate impact on customers by lowering the decoupling surcharge.[22]

D. The Rate Case Moratorium Benefits Everyone Except the Company

RUCO concedes that normally a rate case moratorium is a customer benefit, but argues that Alternative B's five-year moratorium combined with the Decoupling mechanism is actually a Company benefit. Specifically, RUCO claims that Southwest Gas may not adequately or appropriately spend its revenue during the moratorium.[23] Again, RUCO ignores the annual Staff review and the Commission's opportunity to suspend, terminate or modify the Decoupling mechanism at any annual review. Further, as discussed in AIC's Opening Brief, the moratorium really benefits everyone except the Company, because Southwest Gas can't escape any aspect of

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[18] Hr. Tr., Vol. III, p. 679, ll. 15-23.
[19] Hr. Tr., Vol. I, p. 205, ll. 14-19; Hr. Tr., Vol. II, p. 377, ll. 10-23.
[20] RUCO-7, p. 23, ll. 8-10.
[21] RUCO's Opening Brief, p. 7, ll. 11-22.
[22] Hr. Tr., Vol. I, p. 234, l. 17 – p. 235, l. 15.
[23] RUCO's Opening Brief, p. 8, ll. 1-6.

the settlement if it, the economy or any other factor works to the Company's disadvantage.[24] In fact, during the moratorium, the Company is at risk that costs will increase while customer count decreases.[25] Accordingly, all evidence demonstrates the moratorium is a ratepayer benefit.

E. Alternative B's 5% Cap Creates Rate Stability and Gradualism

RUCO also criticizes the 5% cap on increases under Alternative B, arguing that it fails to promote rate stability, because the cap will permit rates to go up 5% each year[26] and that exceeds the range discussed in the workshops.[27] RUCO is wrong on both counts.

The 5% cap applies only to the non-gas portion of the rate. Accordingly, as Mr. Schlegel points out, the cap will actually act as a 2.5% (or less) cap as to rates.[28] That's fully consistent with the range of the 2-3% base revenue cap discussed at the workshops.

F. The Weather Adjustor Provides Immediate Customer Relief

RUCO's opposition to the weather adjustor rings particularly hollow in light of the fact that its witness, Dr. Johnson, testified that such an adjustor benefits customers—especially those on fixed incomes.[29] In fact, as Mr. Olea explained, Staff added the weather adjustor to Alternative A based on RUCO's endorsement.[30]

Moreover, RUCO's claim that the Commission's Policy Statement "discouraged" such a component is clearly erroneous.[31] Several witnesses, again including RUCO witness Johnson,[32] confirmed at hearing that the Policy Statement <u>encouraged</u> a monthly weather adjustor as an

[24] Hr. Tr., Vol. II, p. 349, ll. 6-21.
[25] Hr. Tr., Vol. II, p. 348, ll. 3-9 and p. 350, l. 11 – p. 351, l. 23.
[26] RUCO's Opening Brief, p. 8, ll. 22-24.
[27] RUCO's Opening Brief, p. 15, ll. 9-11.
[28] Hr. Tr., Vol. II, p. 437, ll. 2-19.
[29] RUCO-7 (Johnson Direct Rate Design Testimony), p. 26, l. 24 – p. 27, l. 6.
[30] Hr. Tr., Vol. I, p. 203, l. 16 – p. 204, l. 24.
[31] RUCO's Opening Brief, p. 15, ll. 6-8.
[32] Hr. Tr., Vol. III, p. 612, ll. 2-14.

important, real-time ratepayer benefit.[33] Yet, RUCO continues to argue that the adjustor will reduce the size of customer credits.

The weather adjustor provides a significant customer benefit; it does not reduce the customer's credit or get charged back to the customer in the annual decoupler adjustment. If the weather is colder than normal during a winter month, the customer gets prompt bill relief, so the customer only pays what's required under normal weather conditions. In the following year, when the annual rate adjustment is made, the amount that the customer saved because of the weather adjustor does not return to the Company. That lost revenue is forfeited by Southwest Gas.[34]

G. Other Undisputed Ratepayer and Public Benefits

The Settlement Agreement contains several other provisions that so clearly benefit the public interest and ratepayers that RUCO can't oppose them. For example, the Settlement Agreement includes a number of Company commitments and rate design components that assist low-income customers.[35] Further, Southwest Gas will develop enhanced communication efforts to raise the profile of low-income programs.[36] Also, the Company's energy efficiency plan is designed to produce annual energy savings of at least 1,250,000 therms[37]—savings that even RUCO admits are a real and significant ratepayer benefit.[38] SWEEP estimates that, in just the first year, Southwest Gas's plan will deliver approximately $35 million in total societal benefits and roughly $14 million in net societal benefits.[39] Finally, in sharp contrast to RUCO's proposal,

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[33] Hr. Tr., Vol. I, p. 120, l. 22 – p. 121, l. 8 and p. 204, ll. 11-24.
[34] Hr. Tr., Vol. I, p. 144, l. 19 – p. 145, l. 11; Hr. Tr., Vol. II, p. 277, l. 4 – p. 278, l. 7.
[35] A-14, pp. 15-16, ¶¶ 4.1-4.5.
[36] S-9 (Olea Direct in Support of Settlement), p. 13.
[37] A-14, pp. 16-17, ¶ 5.8.
[38] RUCO's Opening Brief, p. 9, ll. 12-15.
[39] Hr. Tr., Vol. II, p. 439, l. 25 – p. 440, l. 8.

the Settlement Agreement does not increase the monthly service charge, thereby enhancing bill savings through conservation efforts.[40]

Despite RUCO's hypothetical horribles parade, the evidence all points to the fact that the Settlement Agreement and its decoupling mechanisms will help ratepayers and provide substantial public benefits. The record meets RUCO's demand for "proof"[41]—RUCO just refuses to face the facts.

RUCO Highlights and Compounds Misconceptions About Decoupling

RUCO stresses two public misconceptions about decoupling: (1) the more customers conserve, the more they will pay and (2) decoupling will overcompensate the Company. Both are contrary to real-world data.

A. Under Decoupling, Less Gas Usage Equals Lower Bills

The evidence is clear that both the LFCR and Decoupling mechanisms are directly tied to actual reduced energy usage. Thus, the only circumstance under which the Company gets to charge more is when ratepayers use less and, therefore, promptly enjoy lower bills.

RUCO tries to skirt this issue by focusing on the rate adjustment rather than overall bill impact. In fact, RUCO goes so far as to claim that lower bills are "beside the point":

> In fact, the Settling parties argue that if the ratepayer uses less gas they will actually experience lower bills. Transcript at 284-285 for example. *This is true, but it is beside the point*. Under either option, **if ratepayers conserve, their rates go up**. Transcript at 556-557. Their bills may go down because they are using less gas, but their rates will still go up under decoupling.[42]

RUCO's argument is ludicrous—bills are not beside the point, they are the point. Customers care most about the total check they write and the bill amount they have to pay.

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[40] S-9, p. 14.
[41] RUCO's Opening Brief, p. 5, ll. 14-15.
[42] RUCO's Opening Brief, p. 10, ll. 6-10 (bold emphasis in original).

RUCO further compounds this outlandish argument by claiming that customers will be so focused on the "message" that conservation leads to higher rates (which, ironically, RUCO is guilty of perpetuating) that they will (a) ignore the fact that conservation will lower their overall bills and (b) stop conserving. RUCO has not presented a single piece of factual evidence to support its claim that decoupling will lead to less conservation. Indeed, the only evidence on this issue is from Dr. Hansen, who testified to the exact opposite—decoupling has led to statistically significant reductions in use per customer.[43] Further, Dr. Johnson admitted that he does not really believe that consumers will be so outraged by decoupling that they will actually use more gas.[44]

B. No "Revenue Windfall"

The second public misconception that RUCO exploits is the idea that, under decoupling, customers will pay Southwest Gas for gas they do not use and, thus, give the Company a "revenue windfall."[45] Again, RUCO ignores the fact that the mechanisms proposed in the Settlement Agreement are directly tied to the test year <u>fixed</u> costs that the Commission has reviewed and approved as reasonable. Customers never pay for gas they do not use; under decoupling, they pay for fixed costs that the Company incurs in order to provide the gas that customers do use.[46] An opportunity to recover Commission-approved test year fixed costs obviously is not a "windfall." RUCO's argument also completely ignores the protection of the annual review and earnings test built into Alternative B, which are specifically designed to prohibit the Company from over-earning.[47]

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[43] Hr. Tr., Vol. II, p. 265, ll. 8-24.
[44] Hr. Tr., Vol. III, p. 608, ll. 2-5.
[45] RUCO's Opening Brief, p. 6, l. 24 and p. 14, l. 2.
[46] AIC-1, p. 20, ll. 10-18.
[47] A-14, p. 12, ¶ 3.25; Hr. Tr., Vol. I, p. 216, l. 25 – p. 217, l. 10.

RUCO also reiterates David Dismukes' statement that decoupling would have resulted in $62 million in additional revenues if it had been in place in 2007-2010.[48] However, that backcast analysis also showed that if the decoupling mechanism were based on this test year's per-customer usage, it would instead have resulted in a $66 million refund to residential customers during the same timeframe.[49] Second, a separate analysis conducted by the Company pursuant to the Commission's Decision in the last rate case showed that between 2003 and 2008, the largest impact that decoupling would have had on residential customers would have been a 5.4% rate decrease.[50]

A Decoupling Mechanism Is Necessary

Implicit in RUCO's opposition to the Settlement Agreement is the theory that there is no real problem with the status quo or, if there is a problem, it can be fixed by RUCO's $1.15 service charge increase. Dr. Johnson specifically recommended that the Commission maintain the status quo.[51] Likewise, Ms. Jerich stated her belief that the slight increase in the service charge was the best option because a similar increase "worked" in Southwest Gas's last rate case.[52]

The problem with this theory is it's counter to all evidence. RUCO turns a blind eye to what everyone else can see clearly. Southwest Gas has not earned its rate of return since its last rate case. In fact, it hasn't achieved its authorized rate of return under the traditional ratemaking system in more than 15 years,[53] despite increases in its service charges in the past two rate

[48] RUCO's Opening Brief, p. 3, ll. 14-16.
[49] Hr. Tr., Vol. I, p. 78, l. 17 – p. 79, l. 1.
[50] Hr. Tr., Vol. I, p. 87, l. 24 – p. 88, l. 15. *See also* Southwest Gas Revenue Decoupling Report, filed in Docket No. G-01551A-07-0504 on April 3, 2009.
[51] Hr. Tr., Vol. III, p. 571, l. 24 – p. 572, l. 2.
[52] Hr. Tr., Vol. III, p. 700, l. 16.
[53] Hr. Tr., Vol. I, p. 87, ll. 9-18.

cases.[54] Compounding these facts is the reality that, with the adoption of the EE Standards, the Company has no reasonable opportunity to do any better unless a decoupling mechanism is approved.[55] As Mr. Olea explained, failure to approve decoupling under these circumstances denies Southwest Gas the opportunity to earn its authorized rate of return:

> If you set rates knowing they will sell less gas, then you are telling the company, we aren't actually giving you that opportunity.[56]

RUCO's argument that decoupling is not necessary to promote conservation is also devoid of support. Again, witness after witness testified that the disincentive to conservation is a real problem and decoupling is the necessary solution. Even though Staff opposed the Company's decoupling proposals in the prior rate cases, Staff now recognizes that the current regulatory framework does not provide sufficient financial incentive to Southwest Gas to achieve the EE Standards:

> Q. (By Mr. Pozefsky) Do you believe that the Commission's current regulatory framework…provides the company with sufficient financial incentive to encourage conservation?
>
> A. (By Mr. Olea) Not if they are not allowed to get something for that selling of less product.[57]

That decoupling is the answer to this problem is evident in its track record for encouraging energy efficiency and producing tangible results. According to Mr. Schlegel, Arizona utilities have been resistant to SWEEP's efficiency programs while utilities in other jurisdictions with decoupling have been enthusiastic supporters.[58] Likewise, Dr. Hansen observed marked changes

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[54] *See* Decision Nos. 68487 and 70665.
[55] Hr. Tr., Vol. I, p. 86, l. 18 – p. 87, l. 3.
[56] Hr. Tr., Vol. I, p. 211, ll. 3-5.
[57] Hr. Tr., Vol. I, p. 222, ll. 5-10.
[58] Hr. Tr., Vol. II, p. 422, l. 17 – p. 423, l. 19.

in utility behavior following approval of decoupling, including changes in staffing compensation methods.[59] RUCO has not and cannot counter this evidence.

Finally, RUCO ignores the negative consequences to the Company's credit rating and its ability to obtain financing if decoupling is not approved. At the hearing, Ms. Jerich produced a document purporting to summarize the impact that denial of decoupling requests had on the credit ratings of various out-of-state utilities.[60] We have no information about the particular financial conditions of any of these utilities or the circumstances surrounding their credit ratings. What we do know, in the case of Southwest Gas, is one rating agency has specifically foreshadowed that rejection of decoupling in Arizona is likely to be viewed negatively.[61]

The Time for Decoupling Is Now

RUCO also urges the Commission to be cautious and wait for a better time to consider decoupling. Decoupling has been the subject of thorough investigation and discussion for the past seven years. Accordingly, RUCO has had more than enough time to gather evidence regarding the impact of decoupling on residential customers and to identify potential alternatives. RUCO has done its research, but has not found either a decoupling mechanism or a 'better alternative' to present in this case.[62]

Simply stated, RUCO is the archetype for the party described by Mr. Cavanagh—the party who, despite all the research and analysis, "will never be satisfied."[63] That's reinforced by the new list of issues RUCO raises in opposition to the Settlement Agreement.[64]

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[59] Hr. Tr., Vol. II, p. 272, l. 2 – p. 273, l. 16.
[60] RUCO-16.
[61] Hr. Tr., Vol. II, p. 507, l. 14 – p. 508, l. 20.
[62] Hr. Tr., Vol. III, p. 700, l. 22 – p. 701, l. 17 and p. 758, l. 12 – p. 759, l. 14.
[63] Hr. Tr., Vol. II, p. 371, ll. 2-4.
[64] At the Commission's workshops, Ms. Jerich, on behalf of RUCO, listed four prerequisites for adopting a decoupling mechanism. A-17. The five issues raised by Ms. Jerich in opposition to the Settlement Agreement were not included in Ms. Jerich's original list.

First, RUCO asserts that decoupling is inappropriate now because of the poor economy.[65] Yet, RUCO opposed Southwest Gas's prior decoupling proposal in 2004-2006 when the economy was booming. Moreover, Mr. Schlegel noted that approval of a decoupling mechanism in a poor economy is desirable, because, if customer usage increases as the economy improves, customers will receive refunds.[66] The Company is surrendering any upside potential related to increased usage.[67]

Second, RUCO asserts that Southwest Gas must prove that the Company's failure to earn its authorized rate of return in the past was primarily attributable to declining consumption.[68] This argument ignores the undisputed impact of putting much more than half of the Company's fixed costs in the volumetric rate knowing consumption is declining and then, by the new EE Standards, mandating that the Company sell still less volume. As Staff has explained, the EE Standards change the ratemaking environment and require that the Company be compensated differently.[69]

Third, RUCO wants evidence that Southwest Gas is unwilling to promote conservation programs to the "fullest extent."[70] As Dr. Hansen pointed out, this is an unrealistic expectation. It's unrealistic to expect utilities to admit that they are "unwilling" to abide Commission mandates.[71] Further, Dr. Hansen's studies show that removal of the financial disincentive to energy efficiency opens new doors that the companies or their staffs may not have been aware of prior to decoupling.[72]

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[65] Hr. Tr., Vol. III, p. 688, ll. 18-24.
[66] Hr. Tr., Vol. II, p. 477, ll. 7-14.
[67] Hr. Tr., Vol. II, p. 396, ll. 10-22.
[68] Hr. Tr., Vol. III, p. 689, l. 25 – p. 690, l. 4.
[69] Hr. Tr., Vol. I, p. 213, l. 16 – p. 214, l. 3; Staff's Opening Brief, p. 9, ll. 12-14.
[70] Hr. Tr., Vol. III, p. 691, ll. 2-6.
[71] Hr. Tr., Vol. II, p. 298, l. 25 – p. 299, l. 9.
[72] Hr. Tr., Vol. II, p. 297, l. 3 – p. 298, l. 24.

The fourth new prerequisite listed by Ms. Jerich is that decoupling result in a delay in infrastructure costs.[73] As previously explained, this is not the "primary benefit" according to anyone but RUCO. Further, if RUCO's argument is correct, then decoupling would not be appropriate for <u>any</u> gas distribution utility. That is directly counter to the Commission's express inclusion of gas utilities in its Policy Statement endorsing decoupling.[74]

Finally, the last requirement on RUCO's list is that Southwest Gas be in poor financial health.[75] Again, this requirement contradicts the fact that RUCO opposed the Company's decoupling request in the last rate case when its credit rating was just one step above junk bond status. Further, there is evidence that Southwest Gas's financial position is not as rosy as RUCO maintains—as one analyst states, the Company has been issuing "below average" dividends, making it less attractive to investors.[76]

RUCO's timing argument suggests that it would prefer that Southwest Gas (1) continue to under-recover its fixed costs, (2) fail to promote energy efficiency to the fullest extent possible, (3) earn less than its authorized rate of return and (4) receive a credit downgrade—none of which will benefit ratepayers and instead will put at risk the Company's ability to provide customers with safe, reliable and adequate service.

In contrast, approval of the Settlement Agreement and adoption of decoupling in this case will clearly benefit Southwest Gas's customers. As, Mr. Schlegel explained, the Settlement Agreement presents a "watershed" moment:

> [A]nd I would simply submit to the commission that the combination of the energy efficiency standards supported by decoupling is <u>the single best opportunity in more than a decade for customers to actually reduce their energy bills</u>. You can

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[73] Hr. Tr., Vol. III, p. 692, ll. 16-22.
[74] RUCO-1.
[75] Hr. Tr., Vol. III, p. 693, ll. 8-15.
[76] RUCO-5.

> look at any other rate case where you didn't have these provisions combined, and customers out the other end of the rate case, what do they get? They get higher bills and higher rates.
>
> This is the only combination before the Commission in more than a decade that is going to have the opportunity for at least some customers, and significant share of customers, to reduce their bills, whereas virtually every other rate case in front of the Commission results in higher bills and higher rates.
>
> This one, this combination of policies that you are hopefully on the homestretch towards enabling, it doesn't just simply result in bills being not quite as high as they otherwise would be, which is essentially the relatively low-bar objection that most people fight for in a rate case—let's not have the rates be quite so high; let's not have the bills go up quite so much.
>
> <u>In this particular case we actually have the opportunity for a large number of customers have their bills be reduced, and I think that is a watershed in terms of a rate case policy in front of this Commission.</u>[77]

CONSTITUTIONALITY

RUCO's approach to the constitutionality issue is similar to its other arguments. It doesn't find the Settlement Agreement's decoupling mechanisms to be unconstitutional (because they are not), but instead uses the constitutionality question as another excuse for delay.

Contrary to RUCO's suggestion, there is nothing "challenging" about fitting either Alternative A or B into Arizona's fair value requirement.[78] Both are formulas constructed during a rate case in which fair value is ascertained and established. In the case of Alternative A, the formula is based on anticipated lost non-gas revenues premised on achievement of the required savings under EE Standards and true-up to actual lost revenue annually.[79] Under Alternative B, the formula calculates the difference between authorized revenues per customer based on fixed

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[77] Hr. Tr., Vol. II, p. 454, l. 13 – p. 455, l. 13 (emphasis supplied).
[78] RUCO's Opening Brief, p. 20, l. 12.
[79] A-14, pp. 7-8, ¶¶ 3.5-3.6.

costs as determined in the test year and actual revenues per customer with an annual true-up, a 5% cap on non-gas revenue increases and no cap on customer refunds.[80]

Both formulas meet the three tests for adjustor clauses described in *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 578 P.2d 612 (App. 1978):

1. The Commission is considering all of Southwest Gas's fixed and other costs in the test year when the formula rates are established;
2. The fixed cost elements of the formula rates are separately reviewed and identified; and
3. The formulas are set with reference to and based upon the rate of return being established in this rate case.

Specifically, on the third factor, both Alternative A and Alternative B authorize an adjustment that relates directly to the rate case authorized revenues; the only relevant difference is the method of measurement. The LFCR in Alternative A measures the difference between the authorized base non-gas revenues and those lost in achieving the Commission's EE Standards.[81] Alternative B's Decoupling mechanism measures the difference between actual revenues per customer and the base non-gas revenues authorized by the Commission to afford an opportunity to earn the authorized rate of return.[82]

There is no "disconnect between the rates established using fair value and the future rates" as adjusted by the LFCR or the Decoupling mechanism.[83] The formula for either the LFCR or the Decoupling mechanism rate is established in this rate case based upon Commission-approved fixed costs and the established rate of return. RUCO's concept of a future rate is incorrectly focused on the adjustments that will be based on the inputs to these formulae. That

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[80] A-14, p. 10, ¶¶ 3.18 and 3.20 and pp. 13-14, ¶ 3.29.
[81] A-16, p. 5, ll. 13-21.
[82] A-16, p. 7, ll. 6-8.
[83] RUCO's Opening Brief, p. 21, ll. 9-12.

future number, however, is only the result of the formula; the formula, established in this case, is the rate. *See, e.g., California Independent System Operator Corp.*, 90 FERC ¶ 61,315 at 62,042 (2000); *United States Dep't of Energy,* 66 FERC ¶ 61,091 at 61,128, n. 10 (1994).

While the LFCR and the Decoupling mechanism may be relatively "new ground" for this Commission,[84] they thoroughly comply with our Constitution and settled case law and regulatory precedent. Moreover, to the extent that decoupling is a change, it is a necessary change which provides many benefits, carrying the smallest impact on customers as possible.[85]

CONCLUSION

Simply stated, RUCO either misunderstands or ignores both the law and facts in arguing against the Settlement Agreement and its Alternatives A and B. It seems RUCO will never have enough evidence, nor will it perceive a "right time" to implement decoupling.

All other parties have carefully crafted and sponsor a well-balanced Settlement Agreement with numerous customer benefits, safeguards and protections. As importantly, the Settlement Agreement affords Southwest Gas a reasonable opportunity—not an assurance—for the first time in 15 years to earn the rate of return the Commission has found just and reasonable. Finally, in the very real competition for the necessary capital to provide safe, reliable and adequate service to Arizonans, the Settlement Agreement will help level the playing field against the other 40 natural gas utilities serving 65 million residential customers which already have decoupling.

The AIC urges the Commission to approve the Settlement Agreement, including either Alternative A or Alternative B in its entirety.

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[84] RUCO's Opening Brief, p. 23, l. 4. This alleged "new" ground, however, has been plotted and surveyed by this Commission and the parties for seven years.
[85] Hr. Tr., Vol. II, p. 337, l. 8 – p. 338, l. 8.

RESPECTFULLY SUBMITTED this 23rd day of September, 2011.

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